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DEC 7

CHARLES ELMORE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 327.

[redacted]

Consolidated Cases.

BRIEF ON BEHALF OF RESPONDENTS

JOHN W. DAVIS,
NATHAN L. MILLER,
Counsel for Respondents.

CORPORATE PRESS, INC., NEW YORK CITY

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Supreme Court of the United States

OCTOBER TERM, 1932.

No. 227.

RICHARD REID ROGERS,
Petitioner,
against
GUARANTY TRUST COMPANY OF NEW YORK, JUNIUS PARKER, GEORGE W. HILL, VINCENT RIGGIO, J. B. HARVIE, R. J. BOYLAN, and THE AMERICAN TOBACCO COMPANY,
Respondents,
and
C. F. NEILEY, A. C. MOWER, J. K. FLETCHER, CHARLES A. PENN (Deceased), and C. S. KEENE (Deceased),
Defendants,

RICHARD REID ROGERS,
Petitioner,
against
THE AMERICAN TOBACCO COMPANY and T. R. TAYLOR,
Respondents.

Consolidated Cause.

BRIEF ON BEHALF OF RESPONDENTS

Preliminary Statement.

These suits in equity originated in the New York Supreme Court. Plaintiff,* a holder of record of 200 shares of Common Stock and 400 shares of Common Stock B out of 4,688,000 common shares outstanding of The American Tobacco Company, a New Jersey corporation (hereinafter called the "Company"), seeks (1) to obtain cancellation of stock issued pursuant to an Employees' Stock Subscription Plan (hereinafter called "Plan"); (2) to nullify the agreements under which those shares had been allotted to 535 em-

* We shall designate petitioner as plaintiff and respondents as defendants.

ployes of the Company; and (3) to enjoin the execution of the Plan (R., pp. 12, 181, 35-36, 40-42, 131-153).

That Plan was duly authorized by the Company's stockholders pursuant to Sections 1 and 2 of Chapter 175 of the Laws of 1920 of New Jersey* at a special meeting held on July 28, 1930 (R., pp. 198-199, 253-256).

The defenses set up in the answer, are:

(1) Plaintiff has failed to comply with Equity Rule 27 (R., pp. 198-200).

(2) The stockholders of the Company, including plaintiff, have ratified the action of the Board with respect to the allotments made to Directors under the Plan (R., pp. 200-204).

(3) The action is an attempt to regulate the internal affairs of a corporation foreign to the State of New York, of which the United States District Court for the Southern District of New York should decline to take jurisdiction (R., pp. 204-5).

(4) The amount of the compensation paid to the individual defendants, including the benefits under the Plan, was and is fair and reasonable; under the By-Laws of the Company the Directors had the right to fix the compensation of its agents; the allotments under the Plan were in accordance therewith as well as in accordance with the New Jersey statutes (R., pp. 205-232).

After joinder of issue, plaintiff made a motion to strike out the defenses, for judgment *pro confesso,* or, in the alternative, for an injunction *pendente lite* (R., pp. 3, 4-7).

The District Court denied that motion and, in the exercise of its discretion, dismissed the bills of complaint, without prejudice to plaintiff's instituting an action in New Jersey (R., pp. 273-279), for the reason that the case involved the internal management of a foreign corporation, sought can-

* See Appendix A for the text of this Statute, *infra,* pages 54-57.

cellation of an issue of its stock and turned largely upon the construction of a number of New Jersey statutes. The District Court said in part:

> "the validity of the shares sought to be cancelled depends primarily upon the interpretation and effect of the Act of 1920. * * * In addition, plaintiff submits that two other statutes, that of 1917 and that of 1926, must be taken as limiting the operation of the 1920 act. It is obvious that the case presents not merely questions of fact but questions of some complexity under the New Jersey laws. There seem to be no decisions of the New Jersey courts to serve as a guide in the proper construction and possible interrelation of these statutes. The legality of the corporate proceedings which resulted in the issuance of this stock is peculiarly a matter for determination in the first instance by the New Jersey courts"* (R., p. 278).

Plaintiff appealed from the order of the District Court to the Circuit Court of Appeals where he sought final disposition of the case as he does here. Plaintiff did not assign as error to the Circuit Court of Appeals the denial of his motion to strike out and for judgment *pro confesso* (R., pp. 283-4). The Circuit Court of Appeals, by the majority

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* Plaintiff asserts, at page 31 of his brief, that the defendants, in opposing the petition for a writ of certiorari by this Court, took the position that the question of discretionary jurisdiction was out of the case.

To reach that conclusion, plaintiff quotes from only part of a sentence, appearing on pages 11-12 of defendants' brief on certiorari, which quotation, standing by itself, distorts the meaning of the complete paragraph and permits of a perversion of its actual purport.

In the paragraph of defendants' brief, from which plaintiff has quoted an excerpt, defendants were urging that, because plaintiff had requested the Circuit Court of Appeals to consider this cause on its merits—and that Court had done so—plaintiff was not in a position to attack Judge PATTERSON'S ruling as a ground for granting certiorari by this Court.

Defendants, in their brief in opposition to certiorari, contended that the refusal to exercise jurisdiction by the District Court was a matter of discretion. The defendants have pleaded, as a defense, that the Court should refuse to exercise jurisdiction (R., pp. 204-5). They argued the jurisdictional question at length in their brief before the Circuit Court of Appeals. They are, of course, entitled to present that question in this Court in support of the dismissal of the complaint.

opinion, asserted jurisdiction and held, under the applicable New Jersey statutes, that the complaints were properly dismissed for the following reasons:

(1) The Plan complied with the New Jersey statute and was legally adopted (R., p. 292).

(2) The stockholders had given express consent that the directors (if employes) might participate in the Plan and that the directors should act in fixing such participation (R., pp. 292-3).

(3) The fact that the Plan, if approved by the necessary vote of stockholders, would permit the directors to participate therein (providing they were employes), did not disqualify the directors from submitting the Plan to the stockholders as authorized by the statute (R., p. 293).

(4) The stock allotted under the Plan was lawfully issued for cash and services to be rendered; the Company received the benefit of those services (R., p. 293).

(5) The Company's charter did not prohibit it from issuing stock at its par value and as compensation to employes and officers under the Plan (R., p. 293).

(6) The statute does not prohibit, but, on the contrary, permits the allotment of stock to employes at less than the market price; the stockholders, in approving the Plan, authorized the allotment of the stock at a price below the market as additional compensation to the Company's employes (R., p. 294).

(7) Plaintiff failed to comply with Equity Rule 27 (R., p. 295).

The dissenting Judge based his dissent solely upon (1) a proposition which had never theretofore been raised or suggested by plaintiff, namely, that the Plan was not sufficiently detailed to constitute a plan within the meaning of the statute and (2) therefore Equity Rule 27 did not apply.

The District Court entered a decree* dismissing the complaints on the merits, in accordance with the majority opinion of the Circuit Court of Appeals.

The Company's Success Under the Defendants' Management, Which Actuated the Stockholders in Approving the Plan.

The Plan attacked by the plaintiff was submitted to the stockholders and approved by them, for the avowed purpose of giving liberal additional compensation through the issuance and sale of common stock to employes including those who were directors, and "those who were actively engaged in the Company's business," who had made an outstanding success of the Company's business in the face of the most severe competition and extremely adverse business conditions.

The principle underlying this Plan is that the greatest efforts, efficiency and loyalty, will be obtained by the Company if a compensation in addition to a fixed compensation is held out to the men in places of responsibility; compensation of such a nature as to make them feel that they are part owners of the business and that their personal success and prosperity are measured by the success and prosperity they achieve for the Company and its stockholders (R., p. 237). This has been a principle of administration of the Company, conceived early in its history and fully justified by the event (R., p. 237).

The complexity of the Company's activities and the extent of its operations are set forth in the record (R., pp. 205-232).

From 1912,—when the Company was divested of a great part of its business by the decree of this Court (*U. S.* v. *American Tobacco Co.*, 221 U. S. 106),—until 1925, due to competition with other tobacco companies, the cigarette business of the Company had decreased from 37.11% of the national business of all cigarette manufacturers

* Appendix B, *infra*, pages 58-59.

in 1912 to 21.80% in 1925 (R., pp. 205-208). In December, 1925, defendant Hill became President of the Company. Under his management, and in cooperation with the late defendant Penn and other directors, most of whom were employes of the Company, a completely new and different policy was inaugurated in all departments. As a result, the Company increased its sales of "Lucky Strike" cigarettes so that they rose from 20.14% of the national total of all cigarettes sold in 1926 to 38.10% in 1930* (R., p. 208).

In 1930 the total increase over 1929 in cigarettes of all kinds sold in this country was approximately half a billion, whereas the increase in the sale of "Lucky Strike" cigarettes (the Company's product) was over six billion. Therefore, the Company's increase was at the expense of its competitors to the extent of five and a half billion cigarettes (R., p. 236).

The same remarkable growth occurred both with respect to the earnings of the Company and the dividends paid on its Common Stock. In 1926, the first year under defendant Hill's management, the net earnings, after deducting all expenses for management, taxes, and depreciation, were $22,549,094, and the dividends paid were $15,622,486 (Exh. G,** R., p. 96).

In 1930 the Company's net earnings, after deducting all charges and expenses for management, taxes and depreciation, amounted to $43,294,769. It paid dividends on its Common Stock of $29,294,000 (R., p. 96).†

It was with this record of achievement in mind that the stockholders acted in giving approval to the Plan.

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* The Company sold nearly 37,000,000,000 of its "Lucky Strike" cigarettes in the United States in 1929 and 43,212,000,000 in 1930 (R., p. 219). It sold in excess of 300,000,000 of its "Cremo" cigars in 1930 (R., pp. 216, 219).

** All exhibits are annexed to and made part of the complaint.

† The Federal Taxes paid by the Company in 1930 exceeded $150,000,000 (R., pp. 178, 195, 236).

The Result of the Operations of the Company for 1931.

The stock was allotted under the Plan in January, 1931, in part consideration for services to be rendered during the balance of the year. The results of the year's operations demonstrated the benefits to the Company from the stimulation of the efforts of the management and other important employes by the Plan. In the first ten months of 1931 the Company's sales of "Lucky Strike" cigarettes in the United States increased by 2,395,000,000 over the corresponding period of 1930, whereas the sales of its competitors' cigarettes decreased in that period by 4,479,000,000 (R., p. 236). The sale of its Cremo cigars increased from 90,000 a day in 1929, to more than 2,000,000 per day in 1931 (R., pp. 216, 219). The English branch of the Company's business in cigarettes mounted from 365,000 per day to over 12,000,000 per day (R., p. 213). In the first eleven months in 1931 the Company did a greater volume of business and made a greater profit for its stockholders than it had during the corresponding period of 1930 (R., p. 234). It paid an extra dividend of $1.00 per share in March of 1931, and the total dividends paid upon its Common Stock up to December of that year (one of unprecedented business depression) exceeded $28,300,000 (R., p. 209).

The Plan—Its Authorization.

On June 25, 1930, the directors held a meeting in accordance with the provisions of Section 2 of Chapter 175 of the Laws of 1920, at which they authorized the submission of the Plan and a proposed change in capital structure to the Company's stockholders (R., pp. 12, 44-46, 182).

The Plan provided:

> (i) For according to such employes of the Company and its subsidiaries and to those actively engaged in the conduct of its or their business, as might

be selected in accordance with the Plan, an opportunity to purchase shares of the Company's stock, by way of additional compensation for services to be rendered (R., p. 40).

(ii) That the Company's board of directors might at such time or times as it may determine, by way of additional compensation for services to be rendered, offer and allot such stock for subscription, in such amounts and proportions, and at such price, not less than the par value of the shares allotted, payable in full or in such instalments, and upon such other terms and conditions as should be determined pursuant to the authority granted by the board to the president for such purposes (R., pp. 40-41).

(iii) No person was disqualified because of being a director of the Company or any of its subsidiaries (R., p. 42).

(iv) The Plan could be recalled, abolished, revised, amended, altered or changed as provided in Section 3 of Chapter 175 of the Laws of the State of New Jersey for 1920 (R., p. 42).

The Plan was duly adopted in strict compliance with Sections 1 and 2 of Chapter 175 of the Laws of 1920 of the State of New Jersey at the special stockholders' meeting of July 28, 1930 by a vote of 389,553 shares Preferred, 620,086 shares Common, and 1,218,849 shares Common B (R., pp. 185, 198-199, 249). Plaintiff appeared at the stockholders' meeting by a representative and read and filed a statement opposing the adoption of the Plan on practically the same grounds as those which he now urges, and voted his stock against it (R., pp. 14-15); but he stood virtually alone there, as he stands alone now in opposition to the Plan, as only 170 shares Common, 1,995 shares Common B, and 10 shares Preferred voted against the Plan (R., p. 249). Over 80 per cent. of the outstanding stock and more than 99.99 per cent. of that

which was present in person or by proxy authorized the Plan.

At the same meeting, the stockholders duly authorized a reduction in the par value of the Common Stock and Common Stock B from $50 to $25, and an increase in the number of shares of Common Stock from 1,000,000 to 2,000,000 and Common Stock B from 2,000,000 to 4,000,000, each stockholder receiving two shares of the new stock for one of the old (R., pp. 12, 182, 253-255).

The Company's stock was widely distributed and its control was in the hands of the public. The Company then had and now has over forty thousand stockholders (R., p. 238). While the Act required the consent of two-thirds of all classes of stock for the approval of the Plan, the directors collectively did not own or control at any time anything like a majority of the stock (R., p. 200) to say nothing of two-thirds. It was inherent in the Plan, as well as in the Act, that the Plan had to be authorized by the stockholders; and the latter were clearly advised that directors who were active employes were eligible to its benefits (R., p. 49).

After the increase of common stock authorized at such meeting, the prosperity of the Company enabled it to institute immediately, and pay regularly thereafter, regular dividends on each share of common stock old and new at the rate of $5 per annum, in addition to an extra dividend of $1 a share annually, so that the dividends paid to the Company's common stockholders in the first eleven months of 1931 exceeded $28,300,000, as against $15,622,486 paid in the entire year of 1926 (R., pp. 96, 209).

While plaintiff had the right—if dissatisfied because of the adoption of the Plan—to have his stock appraised and to be paid such appraised value (Section 2, Chapter 175), he did not avail himself of this right.

The Unique Services Rendered by the Defendants and the Responsibility Imposed Upon Them.

To maintain the Company's present success and position of preeminence in the tobacco industry, and the resulting profits and returns to its stockholders, requires an organization possessing the highest degree of alertness, ability, loyalty and originality (R., pp. 234-236), all of which are present in the Company's management. A striking example is the creation of the "Lucky Strike" cigarette, which was conceived and launched by the defendants Hill and the late Penn and is the chief product of the Company and the one from which it has made its greatest success (R., pp. 210-211). Many other similar outstanding achievements are shown in detail in the record (R., pp. 210-232).

There is imposed upon the defendants the responsibility of the many departments that constitute the Company, including the purchasing of leaf tobacco, purchasing of supplies, manufacturing, foreign operations, advertising and sales (R., pp. 210-232).

Routine and cursory services would be wholly inadequate to serve the interests of the Company. The stupendous task of the management is manifest from the number of articles that must be manufactured and sold each day, including over 150,000,000 of its "Lucky Strike" cigarettes and 2,000,000 of its "Cremo" cigars. The profit on each cigarette and cigar is but a fraction of a cent, so that the slightest variation of cost may result in a loss instead of a profit (R., pp. 235-237).

The Allotment of Stock Under the Plan.

Following the stockholder's approval the Company's board of directors at a meeting held on January 28, 1931, evolved a formula* for the allotment of stock

* This formula is discussed in detail at pages 35-36, *infra*.

under the Plan. Under the formula the compensation paid to each participant for the year 1930 was the general measuring rod in allotting stock under the Plan. The maximum allotment to any participant was limited to an amount of stock having a par value equal to one-third of his compensation for the year 1930. To allow for variations of efficiency and ability, each participant was to be given a rating upon a percentage basis in comparison with a key man in the same department. The actual number of shares to be allotted to each participant was arrived at by applying such percentage to one-third of the compensation received by the participant for the year 1930.

The board thereupon submitted to the President a list of employes who were considered by the board to be entitled to participate under the Plan, and also recommended that the defendants Hill and the late Penn (neither of whom was present at the meeting) each be given a rating of 100% (R., pp. 188-189).

At a subsequent meeting, the board accorded 535 employes, including directors who were active employes, the right to subscribe to a fixed number of shares at the par value of $25 per share, in addition to their services until December 31, 1931, upon the terms and conditions described in an agreement (Exh. G) between the Company, the respective employes, and Guaranty Trust Company of New York and Junius Parker—the latter named as Trustees in the agreement. The number of shares allotted to each participant was determined in accordance with the formula. Under the agreement the stock certificates could not be delivered to any subscribing allottee until the purchase price, and all interest accrued thereon, should be paid in full; but, in any event, not until after December 31, 1931. *If before that date any allottee should resign or be discharged, the Trustees had the power to cancel forthwith any right of such allottee under the agreement to have delivery of the stock* (Exh. G, R., pp. 91-130).*

*All italics in this brief are ours unless otherwise indicated.

The Allotments of Stock Reported to Stockholders Prior to the Annual Meeting of April 1, 1931.

The Company, on January 28, 1931, announced through the newspapers that its directors had voted to allot to employes, including directors who were employes, 56,712 shares of the Company's Common Stock B pursuant to the authority conferred upon them under the Plan (R., pp. 200-201). In early March, 1931, the Company mailed to each stockholder of record, accompanying the annual report and notice of the annual meeting of the Company to be held on April 1, 1931, a pamphlet (Exh. G) setting forth what had been done by the Company in carrying out the Plan, with a copy of the subscription agreement with allottees and the trust agreement above mentioned, and stating the exact number of shares allotted to the President, the number allotted to the five Vice-Presidents, and the number allotted to each of the other 529 employes (R., pp. 201, 91-130).

Prior to this annual meeting of April 1, 1931, plaintiff inserted in the newspapers an advertisement in which he voiced his criticism of the Plan, as well as of other payments made, and of the Company's management (R., pp. 202, 8-9).

Plaintiff stated in that advertisement:

> "But in the meantime, I do not know whether the stockholders desire to *approve even indirectly* these exorbitant payments, whether as salaries or as gifts; or whether they are disposed to approve a trend in corporate management in this country which is or may prove pernicious.
>
> "I advise the stockholders, therefore (whom I am unable to reach in any other way), who do not approve of this policy, not to send in their proxies to Mr. Hill, but either to appear in person or give their proxies to someone who will not vote approval. While I am not personally seeking proxies, I will state that any

> proxies sent to me will be voted against approval of these salaries, bonuses or gifts. Later proxies will cancel earlier ones" (R., p. 9).

Plaintiff also gave out interviews to reporters of various newspapers, subsequently published, which criticized the board of directors of the Company and were given for the purpose of obtaining proxies for use at the annual meeting (R., p. 202).

At that annual meeting the entire board of directors were reelected by the largest number of votes ever cast at any annual meeting in the history of the Company (R., p. 204). The numbers of votes that were cast for the successful candidates varied from 2,608,201 to 2,615,973, whereas the number of votes cast for the sole candidate advanced by plaintiff was 11,980 (R., p. 203). Plaintiff himself voted for all of the directors with the exception of defendant Hill (R., p. 203).

If these directors had been defeated for reelection, clearly a new board could not have retained them as executives in face of the stockholders' disapproval as evidenced by such defeat, and they would have been unable to complete the year's service as required by the agreement under which the stock was allotted (R., pp. 204, 115-116).

The candidate nominated by plaintiff to take the place of Hill was one who had had no experience in the tobacco business, having been engaged for a number of years in the steamship business, and of whom plaintiff stated at the meeting, after nominating him, that he *"did not know him, of him or about his qualifications"* (R., pp. 203, 238-239).

Plaintiff in his desire to prevent Hill from being reelected as a director of the Company was thus willing to imperil and prejudice the investment of some 40,000 stockholders by putting forward his unknown and untried candidate (R., p. 238).

The Rights of the 521 Employes, None of Whom Was a Director.

There are 521 employes to whom stock was allotted under the Plan who were not Directors. None of these employes was named as a defendant or served with process. The record shows that these 521 employes are employed in many different States in the Union, as well as in foreign countries (Exh. H, R., pp. 131-153).

The Company, under the authority conferred by the stockholders as above described, made a contract with each participant under which such participant was to receive stock allotted to him, provided payment therefore was made in cash and services were rendered throughout the year (Exh. G, R., pp. 91-130).

Each one of those employes has completed the services which were part consideration for the allotment of the stock; and each is entitled to be heard before his rights in this stock are stricken down.

Summary of Argument.

I. Plaintiff has failed to comply with Equity Rule 27.
(In Response to Plaintiff's XI.)

II. The action is an attempt to interfere with the internal management of a foreign corporation engaged in a nation-wide business, affecting rights of persons not parties to the action who reside in many jurisdictions other than New York. As such the courts of the corporate domicile afford the proper forum.
(In Response to Plaintiff's X.)

III. The directors were not disqualified from constituting a quorum or voting for the submission of the Plan to the stockholders pursuant to the provisions of the New Jersey statute.
(In Response to Plaintiff's I.)

IV. The notice to stockholders submitting the Plan for their approval omitted none of the essential facts.
(In Response to Plaintiff's II.)

V. The Plan conformed to the statute.
(In Response to Plaintiff's III.)

VI. The Plan was not an invasion of any stockholder's pre-emptive right.
(In Response to Plaintiff's IV.)

VII. There was no disposition of corporate assets contrary to the charter.
(In Response to Plaintiff's V.)

VIII. Chapter 175, Laws of 1920, State of New Jersey, as well as the General Corporation Law of New Jersey, authorized the allotment of stock to employes at its par value and the services to be rendered by the allottees.
(In Response to Plaintiff's VI.)

IX. The allotment of the stock, to be delivered only when the employe should have completed his services for the balance of the year and paid in cash the par value of the stock, was neither a violation of the directors' fiduciary obligation nor a waste of the Company's assets.
(In Response to Plaintiff's VII.)

X. The resolutions authorizing allotment of the stock were made under the express authority conferred upon the directors by the stockholders.
(In Response to Plaintiff's VIII.)

XI. The allotment of the stock in January 1931 "by way of additional compensation for services to be rendered" was authorized by the statute and by the Plan.
(In Response to Plaintiff's IX.)

XII. Conclusion.

THE SUIT REPRESENTS AN ATTEMPT BY PLAINTIFF—WHO OWNS LESS THAN 1/100 OF ONE PER CENT. OF THE COMMON STOCK—TO OVERRIDE THE EXPRESS MANDATE OF HIS FELLOW STOCKHOLDERS.

The plaintiff is opposed to profit sharing plans of any kind and believes that they constitute a "pernicious" trend in corporate affairs (R., p. 9). His theory of corporate

management is that officers and employes should receive only a fixed salary. He, of course, had the right, when the matter was presented for stockholders' action to attempt to persuade his fellow stockholders to adopt his views. In such efforts he has failed completely, and no other stockholder has joined him in the present litigation although his bill extends to all an invitation so to do. Standing alone, therefore, as he does, owning but 600 out of 4,688,000 shares of common stock outstanding, he should not be permitted to impose his policy upon the Company against the wishes of the other stockholders.

Plaintiff is determined to frustrate the settled policy of one of this country's most successful industrial enterprises for the upbuilding of its business and the stimulation of the efforts of its invaluable employes.

Such a success as has been achieved by this Company did not come about by the mere fortuitous workings of chance. It is the result of highly concentrated and thoroughly trained human service.

This Company has adopted as its cardinal business principles, the following:

1. Its directors and executives must be men capable of exercising broad vision and of understanding large affairs and difficult problems.

2. As a principle of business administration these men should be given their life stakes and the realization of all their ambitions within the compass of the Company's success.

According to the view of an overwhelming majority of the stockholders the prosperity of this enterprise depends upon the key men participating in the profits of the business, so that their success will be wrapped up in the Company's continued prosperity (R., p. 237). The Company's recognition of this principle has brought it to its present success and

preeminence, and the future of the Company depends upon its continued adherence thereto (R., p. 236).

The fruition of that policy is shown by the achievements accomplished thereunder.

ARGUMENT

I.

Plaintiff has failed to comply with Equity Rule 27.

The complaint does not allege that any demand was made by plaintiff upon the stockholders to take any action with respect to the Plan, or give the causes of plaintiff's failure to seek such action, or any reason for not making the effort. The complaint does not allege that defendants owned or controlled the majority of the outstanding stock of the Company. The complaint does not allege any combination of the majority of the stockholders. The complaint contains no allegation that an appeal to the stockholders would be futile or that any emergency existed that warranted plaintiff in not resorting to the stockholders.

The great number of cases involving stockholders' actions disclose that they can be brought for only a few purposes, that the grievance must be clearly shown to be real, calculated to cause irreparable injury, and that every means of redress within the corporation itself has been exhausted or clearly shown to be unnecessary and futile by reason of hostile control. When it is considered what injury may, in many instances, be done to a going and solvent corporation by having its management assailed by vexatious suits of this character at the instance of minority stockholders, it seems inevitably to follow that recourse should be had to the stockholders themselves before an action of this kind is brought.

Notices for the stockholders' meeting were sent out on June 25, 1930. The Plan was adopted by the stockholders

on July 28, 1930. The allotments were made and announced on January 28, 1931.

Plaintiff's action was not commenced until the latter part of February, 1931. He had all the intervening time to make a demand upon the stockholders, to institute action, or to take steps with respect to the repeal of the Plan in accordance with the remedies available to him.

Plaintiff could have applied to the Courts of New Jersey for an injunction before the Plan was passed upon by the stockholders. *Scott* v. *P. Lorillard Co.,* 108 N. J. Eq. 153, affd. 109 N. J. Eq. 417; *Berendt* v. *Bethlehem Steel Corporation,* 108 N. J. Eq. 148.

Passing this, the State of New Jersey has, in effect, what is a referendum and recall with respect to corporate management. New Jersey is unique in this respect as it is the only State to our knowledge that has such a statutory provision.

This statute is Section 46, Chapter 185 of the Laws of 1896 of the State of New Jersey. The germane provisions of that Act provide:

> "* * * three or more stockholders having voting powers may call [a] meeting by publishing ten days' notice of the time, place and purposes of the meeting in a newspaper published in the county in which its principal office in this state is located, and mailing such notice to all stockholders whose post office address is known or can be ascertained; a meeting called as aforesaid shall be a *legal meeting* of the corporation, * * *."

Thus, plaintiff under that statute could have joined with any two stockholders to call a meeting for the purpose of taking action with reference to the Plan.

By Section 3 of the Act under which the Plan was authorized, it is provided that:

> "Any plan adopted * * * may be recalled, abolished, revised, amended, altered or changed in

the same manner as is herein provided for its adoption; * * *."

Under the provisions of that statute, plaintiff could have gone to the stockholders and asked them to take action to rescind the Plan. He argues that the Plan could be changed or abolished only by first having a directors' meeting declaring that it was inadvisable. The fallacy of that contention is that it gives no consideration to the provisions of L. 1896, Chap. 185, § 46, *supra*.

Those two sections read together demonstrate that any meeting called by three stockholders would be a "legal meeting," no matter how many stockholders attended, which could, in the matter of action upon the Plan, take the necessary steps to obtain its rescission or modification.

Plaintiff cites no New Jersey case in support of his adverse construction of the statute, and there is none.

The statute authorizing the Plan gave a dissenting stockholder the right of appraisal (L. 1920, Chap. 175, § 2). That section of the statute provided that a stockholder who did not vote in favor of the Plan could within thirty days after the Plan was adopted file with the Secretary of the Company a dissent in writing therefrom, and could apply, within ten days after the filing of such dissent and upon five days' notice to the corporation, to the Circuit Court of the county in which the Company had its principal office, for the appointment of three disinterested appraisers to appraise the fair value of his stock. This right was afforded to any stockholder whose stock was issued prior to the enactment of the statute in 1920 and was therefore applicable to plaintiff, who had been a stockholder since 1916 (R., p. 12).

The New Jersey Legislature thus indicated a legislative intent that the mandate of two-thirds of the stockholders approving the Plan under the Act was to be final and conclusive upon the corporation and all of its stockholders, notwithstanding the fact that some stockholders might dissent;

but that, in order to avoid any possible claim of unfairness to such dissenting stockholders, they were to be afforded the opportunity to sell their stock to the corporation immediately at a fair price.

Plaintiff overlooks the controlling decisions of this court, *United Copper Co.* v. *Amalgamated Copper Co.*, 244 U. S. 261; *Wathen* v. *Jackson Oil Co.*, 235 U. S. 635. His contention is that Rule 27 should not be held applicable in the instant situation because the Company is large and its stock is widely distributed. There is no such exemption stated in Rule 27 and there has been no such distinction made in any of the cases interpreting that rule. To give sanction thereto would be to abrogate the rule as to all large corporations whose stock is held by the public.

In *United Copper Co.* v. *Amalgamated Copper Co., supra,* Mr. Justice BRANDEIS said (pp. 263-4):

> "Courts interfere seldom to control such discretion *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment; *and, as a rule, only after application to the stockholders, unless it appears that there was no opportunity for such application,* that such application would be futile (as where the wrongdoers control the corporation), or that the delay involved would defeat recovery."

None of these exceptions applies to the instant case.

In *Stone, et al.* v. *Holly Hill Fruit Products, Inc.*, 56 Fed. (2d) 553, SIBLEY, C. J., in sustaining a dismissal of the complaint, because of a failure to comply with Rule 27, stated:

> "* * * If it had been distinctly alleged that all four of the directors who are joined as defendants were so involved as to make application to them obviously futile, there should have been an effort made through the stockholders to control or supplant them.

It is not alleged that there is any wrong combination of a majority of the stockholders, but only that they live at a distance, are ignorant of the situation, and send their proxies to the president. The plain remedy for that would be to seek another stockholders' meeting, after informing the other stockholders of the situation and asking them to withdraw their proxies and to attend. A stockholder, in taking stock in the ordinary corporation, submits, within the charter limits, to a guidance of the corporate affairs according to the will of the owners of a majority of the stock and through the directors whom the majority choose. The minority have a right to have the majority exercise their judgment, and to exercise it honestly and not fraudulently, but have no right to have a court substitute their own ideas and wishes for those of the majority, and that in advance of any refusal of the majority to hear and decide on the matter at issue. Minority stockholders may not in the absence of sudden emergency ask a court of equity to interfere in the management of their corporation until they have earnestly and unsuccessfully sought redress from the Board of Directors, and where appropriate also from the stockholders in meeting, unless they can show sufficient reasons for not doing so. This is implied in the provisions of Equity Rule 27 (28 USCA Sec. 723)."

Continental Securities Company v. *Belmont,* 206 N. Y. 7, cited by plaintiff, was a case arising under the New York law respecting a New York corporation and, as there pointed out, stockholders of corporations of that state cannot act in relation to the ordinary business of a corporation; the only power lodged with them is to change the personnel of the board of directors.

Even there the court said (p. 19), "* * * If the subject-matter of the stockholder's complaint is for any reason within the immediate control, direction or power of confirmation of the body of stockholders, it should be brought

to the attention of such stockholders for action, before an action is commenced by a stockholder unless it clearly appears by the complaint that such application is useless."

In New Jersey shareholders have much broader powers with respect to the affairs of a corporation than in New York. This being a New Jersey corporation, the statutes governing New Jersey corporations and the decisions of the New Jersey courts should be given their full weight by the Federal courts.

II.

The action is an attempt to interfere with the internal management of a foreign corporation engaged in a nation-wide business, affecting rights of persons not parties to the action who reside in many jurisdictions other than New York. As such the courts of the corporate domicile afford the proper forum.

It was on this ground that the learned judge of the District Court, applying the doctrine of *forum non conveniens*, dismissed the plaintiff's bills of complaint without prejudice to further proceedings in the courts of New Jersey.

The general right of a court, even where jurisdiction technically exists, to decline its exercise in favor of a more appropriate forum is well settled. *Canada Malting Co., Ltd.* v. *Paterson Steamships, Ltd.*, 285 U. S. 413; *Cuba Railroad Co.* v. *Crosby*, 222 U. S. 473; *Langnes* v. *Green*, 282 U. S. 531; *Heine* v. *New York Life Insurance Co.*, 50 Fed. (2d) 382.

The record discloses that a great many of the allottees are employed in places other than the State of New York (Exh. H, R., pp. 149-150). Indeed plaintiff alleges in his complaint "In addition to such individual defendants, there are and were from 1929 to February 1, 1931, seven other directors of the said company, none of whom are residents of this State [New York] * * *" (R., p. 11). As the Com-

pany's activities are world-wide, so the beneficiaries of the Plan are scattered throughout the world. Plaintiff has not even attempted to name as defendants the other 521 employes who are not directors.

The action is an attempt to obtain a cancellation of stock issued by a New Jersey corporation. The jurisdiction, and only jurisdiction, in which the rights of the 528 employes who were not named as parties can be protected would be New Jersey, the state of domicile of the corporation.

A decree rendered by a New Jersey court in an action for cancellation would be binding upon all who might assert any rights in the stock sought to be cancelled therein, as such decree would be rendered in a proceeding *in rem,* where proper service could be obtained by publication. (New Jersey Practice Act of 1903, Sec. 84; *Pennoyer* v. *Neff,* 95 U. S. 714; *Jellenik* v. *Huron Copper Mining Co.,* 177 U. S. 1; *Andrews* v. *Guayaquil & Quito Ry. Co.,* 69 N. J. Eq. 211; *Pilger* v. *U. S. Steel Corp.,* 102 N. J. Eq. 506; *Holmes* v. *Camp,* 219 N. Y. 359; *Matter of Ulmann* v. *Thomas,* 255 N. Y. 506).

In the *Andrews* case, the court said (p. 214):

> "If the company is a New Jersey company, then the situs of its stock is in New Jersey, and any question relating to it may be determined here. Such is the decision of the supreme court of the United States in the recent case of *Jellenik* v. *Huron Copper Mining Co.,* 177 U. S. 1. The provisions of our statutes (Execution Act, Gen. Stat. 1415 § 4; Corporation Act of 1896 p. 280 §§ 7, 8, 20) are substantially similar to the Michigan statutes that were under consideration in that case."

The Company is not one that, as a matter of convenience, was organized in New Jersey and which keeps all, or substantially all, of its assets and does all of its business in another single state. Its activities are world-wide. Its prin-

cipal office is located in New Jersey and all of its stockholders' meetings are there held (R., p. 69). It has factories and a number of branches in that state and maintains bank accounts there (R., p. 229).

Not only have many of the statutes involved never been construed, but their interrelation never has been passed upon by the courts of New Jersey. The construction of those statutes is a vital factor in the determination of the present cause. This is apparent from the complaint as well as from plaintiff's brief, where he asserts at different places the construction and effect of his interpretation of the different statutes.*

The rule is clear that a court other than one of the corporate domicile will decline to assert jurisdiction of an action involving the internal affairs of a corporation, especially when the decision must turn upon the statutes and decisions of the domiciliary state. (*Cohn* v. *Mishkoff Costello Co.*, 256 N. Y. 102; *Matter of People* (*Russian Reinsurance Co.*), 255 N. Y. 415; *Powell* v. *United Assn. of Plumbers and Steamfitters*, 240 N. Y. 616; *Sauerbrunn* v. *Hartford Life Insurance Co.*, 220 N. Y. 363; *Cuppy* v. *Ward*, 187 App. Div. 625; affd. 227 N. Y. 603; *Wallace* v. *Motor Products Corp.*, 25 Fed. (2d) 655, cert. denied, 279 U. S. 859.)

The courts of New Jersey manifest the same reluctance to interfere with the affairs of a foreign corporation. (*Jackson* v. *Hooper*, 76 N. J. Eq. 592; *Eckrode* v. *Endurance*

* The construction of the following New Jersey statutes is involved in this cause: General Corporation Act, § 1 L. 1896, Ch. 185, § 1) (Powers of Corporation); General Corporation Act, § 46 (L. 1896, Ch. 185, § 46) (Three Stockholders can call meeting); General Corporation Act, § 47 (L. 1896, Ch. 185, § 47, as amd. L. 1901, Ch. 110, § 2 as amd. L. 1926, Ch. 318, § 14) (Power of Directors respecting capital and dividends); General Corporation Act, § 121 (L. 1920, Ch. 168, § 1, as amd. L. 1921, Ch. 284, § 1, amd. L. 1926, Ch. 318, § 15, supplementing L. 1896, Ch. 185, amd. L. 1930, Ch. 120) (Issuance and sale of shares); General Corporation Act, § 124 (L. 1926 Ch. 318, § 16) (Rights of stockholders respecting new stock issued for cash); General Corporation Act, § 151 (L. 1917, Ch. 195, § 1) (Issuance of stock for labor); General Corporation Act, §§ 158-158c (L. 1920, Ch. 175, §§ 1-4) (Statute authorizing the Plan).

Tire & Rubber Co. of New York, 90 N. J. Eq. 129, affd. 91 N. J. Eq. 153.)

Those cases are particularly apt because they both involve refusal of the courts of New Jersey to take jurisdiction of matters concerning the internal affairs of a New York corporation.

The plaintiff relies upon *Williamson* v. *Missouri-Kansas Pipe Line Co.,* 56 Fed. (2d) 503. That case did not purport to overthrow the rule that a court of foreign jurisdiction will not interfere with the internal affairs of a corporation where those affairs relate to matters which involve construction of the laws of the state of corporate domicile.

The quotation by plaintiff, on page 32 of his brief, shows the fundamental difference between the situations presented.

The Delaware corporations there under attack had no assets in Delaware, transacted no business there, maintained only statutory offices, and had no officers or directors resident there. Furthermore, all the transactions complained of were consummated in Illinois, and a substantial part of the properties and assets were located in Illinois under the direct supervision of the Illinois District Court. The *Williamson* case represents a perfect example of the situation distinguished by PATTERSON, *D. J.,* in his opinion in the District Court: "If the enterprise is really a local one, with practically all its activities confined to the state where suit is brought, a domicile elsewhere, purely technical, may not receive tender treatment" (R., p. 277).

A judgment of the District Court for the Southern District of New York directing cancellation of the stock in controversy could not be effective in the courts of New Jersey as against a suit brought in that state by an employe not a party to this cause.

In the *First National Bank of Lyndhurst* v. *Bianchi & Smith,* 106 N. J. Eq. 333, the court pointed out that (p. 335): "But this court is not bound by that decision. In construing

state statutes it is the province of our courts to lead, not to follow, those of federal or other foreign jurisdictions."

That decision is in conformity with the case of *Kimball* v. *St. Louis & San Francisco Railroad Co.*, 157 Mass. 7, where stockholders of a Missouri corporation brought suit in Massachusetts to enjoin an issue of bonds which the corporation proposed to sell. The court dismissed the bill, Mr. Justice HOLMES saying (p. 8):

> "But it seems to us clear that, as among the states of this Union, the plaintiffs ought to resort in the first instance to that court which alone can declare the law of the case with authority, and can compel obedience to it by force. It would be a misuse of our powers to attempt to control the action of those courts, in a case like this, by an adjudication which would depend upon them for enforcement, and which they might say had mistaken the Missouri law."

III.

The directors were not disqualified from constituting a quorum or voting for the submission of the Plan to the stockholders pursuant to the provisions of the New Jersey statute.

The New Jersey Act of 1920 (Appendix A) provides "that the privileges and powers" granted by the statute may be "exercised in the manner following: * * * the board of directors shall first formulate such plan or plans and pass a resolution declaring that in its opinion the adoption thereof is advisable, and shall call a meeting of the stockholders to take action thereon. * * * If two-thirds in interest of each class of stockholders present at said meeting and voting shall vote in favor of any such plan or any modification thereof, the said plan shall thereupon become operative."

The plaintiff contends that since, under the provisions of the Plan, directors who were also employes were eligible to

share in its benefits, all of such directors (constituting, with one exception, the entire membership of the board) were disqualified from voting for the preliminary resolution required by the statute as a prerequisite to the submission of the Plan to the stockholders.

It is clear, however, that no director was dealing with himself in voting for such a preliminary resolution, the effect of which was merely to bring up the matter for consideration by the stockholders. The Plan was the act of the stockholders, not of the directors. No director could know in advance whether the holders of two-thirds of the stock of the Company would approve the Plan. The stock of the Company was widely distributed and the directors did not own or control even a majority of the stock, while the statute required the approval of the holders of two-thirds of the stock of the Company (R., p. 200). Moreover, no director could know on June 25, 1930, the date of the directors' meeting, whether, in the event the stockholders should approve the Plan, he would be an employe at the time of any allotment made under it.*

If plaintiff's contention were sound, it would automatically preclude any New Jersey corporation, all or a majority of whose directors were employes, as is the case with this Company, from putting into effect a plan under the Act by the terms of which director-employes might be permitted to participate, although the New Jersey Legislature obviously intended that the benefits of the statute should be open to all New Jersey corporations.

The plaintiff's contention is also irreconcilable with the well-established rule in New Jersey that, in the case of transactions in which there is an original infirmity because of the participation of interested directors, such defect is entirely cured by ratification by the stockholders (*Hodge* v. *United*

* Since the Plan has gone into effect, the following defendants have died or resigned: Penn, Mower, Fletcher and Keene.

States Steel Corp., 64 N. J. Eq. 807; *Pierce* v. *Old Dominion Co.*, 67 N. J. Eq. 399; *Purchase* v. *Atlantic Safe Deposit & Trust Co.*, 81 N. J. Eq. 344, affd. 83 N. J. Eq. 353; *Lillard* v. *Oil, Paint and Drug Co.*, 70 N. J. Eq. 197).

This is also the rule of this Court (*Leavenworth* v. *Chicago Railway Co.*, 134 U. S. 688).

In the *Hodge* case, *supra*, the Court of Errors and Appeals had before it the following state of facts:

The Steel Corporation's board of directors, comprising twenty-four members, had resolved "that it would be *advisable* to decrease the capital stock of the corporation to the extent of two million shares, and to retire them by means of an issue of bonds," and "called a meeting of the stockholders * * * for the purpose of voting upon the proposed plan for the purchase and retirement of that amount of preferred stock * * *."

Prior to the notice of that meeting, the directors had entered into an underwriting contract with a syndicate of which more than fifteen members of the Board of Directors were parties. The notice advised the stockholders of the directors' interest *but not of its extent.* The effect of the agreement was to enable the syndicate to make a commission of $8,000,000.

The highest court of New Jersey, in upholding the transaction, said, after referring to the rule that directors cannot lawfully enter into a contract with the company without the knowledge and consent of the stockholders (p. 814):

> "The rule is imbedded in our jurisprudence, and it cannot be too strongly stated or too rigorously applied. But in the cases cited the contract was made by the trustee without the knowledge or consent of the *cestui que trust* and without subsequent ratification or adoption by which the vice in it could be cured.
>
> * * * * * * * * *

"It is a settled rule of corporation law that the personal interest of directors renders a transaction voidable at the option of the stockholders, and not void *per se.*

* * * * * * * * *

"*A fortiori,* when the contract is entered into by the stockholders with the directors, or when the stockholders expressly authorize the directors to enter into a contract, when the stockholders have notice of the directors' interest, the agreement will be unassailable in the absence of actual fraud or want of power in the corporation."

The two cases cited by plaintiff (*Kavanaugh* v. *Kavanaugh Knitting Co.,* 226 N. Y. 185, and *Barrett* v. *Bloomfield Savings Institute,* 64 N. J. Eq. 425) have no application to the case at bar.

In the *Bloomfield* case, the question arose under a New Jersey statute empowering the managers of a savings institution to dissolve. Such a bank had no stockholders, so that the power to dissolve rested solely with the managers. It appeared that the managers were exercising such power in order to sell the assets of the savings bank to a trust company which they owned, and no legitimate ground for dissolution of the savings bank was shown. The Court held that the public as well as the depositors had an interest in the maintenance of such a banking institution, and that, under the circumstances, the Court should exercise a power of review with respect to the action of the managers.

In the *Kavanaugh* case, the question presented was whether the complaint stated a cause of action. It appeared that the defendants, directors who were also majority stockholders, were dissolving a prosperous corporation against the protest of the plaintiff, a minority stockholder, who had theretofore brought an action seeking to compel the defendants to account for their malfeasance in office. The dissolution was a step in a scheme of directors who were the majority stockholders to turn over the assets to a new corporation

to be owned solely by themselves. It was not a transaction in which the action of the directors was to be submitted to independent majority stockholders for approval.

The other cases cited by plaintiff in this connection are equally inapplicable for like reasons.

IV.

The notice to stockholders submitting the Plan for their approval omitted none of the essential facts.

Plaintiff's theory seems to be that the Plan was void in its inception because the letter to stockholders accompanying the notice of the special meeting of July 28, 1930 did not refer to other stock plans which had been in effect in the past or to the fact that the chief executives were receiving compensation under Article XII of the by-laws, adopted by the stockholders of the Company in 1912.

These stock plans related to past periods, for the most part many years prior to 1930. The services which they were designed to compensate had long since been performed, to a large extent by others than those who were the allottees under the Plan (R., pp. 167, 131-153). There is no allegation in the complaint that the amounts paid under such prior plans were excessive for the services rendered.

These prior stock plans and the payments of compensation made in connection with them do not rest upon the Act of 1920 but upon the authority which has always been inherent in the board of directors of every New Jersey corporation to pay compensation to employes including such as were directors. See *infra,* pages 36, 37.

Plaintiff has made the prior stock plans the subject of a separate litigation which has not yet been reached for trial, and any question as to the validity of such prior stock plans will be disposed of on the issues joined in that suit. These prior plans must stand or fall by themselves. It is obvious

that the merits of that litigation are not germane to the instant suit and can neither be heard nor determined here.

These former plans had no relevancy to the new Plan, which related to services to be performed in the future, and there was no reason whatever why they should have been mentioned in the circular letter.

Nor was there any reason whatever why mention should have been made of the provision which this Company, like most other large corporations, was making for medical services and pensions "to deserving employes" who had been retired either by physical disability or old age.

The profit-sharing participation of the President and certain Vice-Presidents pursuant to Article XII of the by-laws could not have been a matter of secrecy as it had been actually adopted by vote of the stockholders themselves; it was known as inherent in the Company's business policy ever since publicly adopted in 1912. Plaintiff has brought a suit attacking the by-law, which has been decided adversely to him. *Rogers* v. *Hill et al.*, 60 Fed. (2d) 109. While the plaintiff claims that the by-law provision was unknown to him, he does not allege that it was unknown to the other stockholders, and both he and all other stockholders had, at least, constructive notice of all the provisions of the by-laws. (*Giesen* v. *London and Northwest American Mortgage Co.*, 102 Fed. 584; *Richardson* v. *Devine*, 193 Mass. 336; *Kavanaugh* v. *Commonwealth Trust Co.*, 223 N. Y. 103, 107; *Baumohl* v. *Goldstein*, 95 N. J. Eq. 597.)

As a further indication that these several matters were immaterial, it appears that the plaintiff himself had no difficulty, from the information furnished by the notice of the special stockholders' meeting and the circular letter and copy of the Plan accompanying the notice, in formulating his opposition to the Plan, his statement of which at the time of the special meeting was based on substantially the same grounds as those which he has ever since

maintained in opposition to it (R., p. 15). On the other hand, the other stockholders of the Company, notwithstanding the detailed information which they, as well as plaintiff, have received from time to time regarding all of these matters, both directly from the Company (Exh. G, R., pp. 91-130) and from the widespread publicity which the case has received during the pendency of this suit, have not only refrained from joining or supporting the plaintiff in his litigation, but have continued to reelect the same directors and management by overwhelming vote.

Plaintiff refers to a letter (in response to a communication from plaintiff revoking his proxy) sent by one of the defendants to plaintiff's associate, some six months prior to the date on which the Board allotted the stock, and, of course, at a time when no price had been fixed. The letter contain nothing that could possibly be regarded as a misstatement. Plaintiff did not thereafter send his proxy, but, on the contrary, in attacking the Plan at the special stockholders' meeting, stressed the fact that the directors could issue the stock at par (R., p. 15).

The length to which plaintiff goes in his search for grounds of complaint is perhaps best indicated by his criticism of the language of the circular sent to the stockholders with the notice of the meeting. At that meeting the par value of the common stock was to be reduced from $50 a share to $25 a share, and the number of common shares was to be doubled, and the letter stated that if the program outlined in the letter was approved, it was expected that an extra dividend of $4 a share on all of the old stock would be paid and regular quarterly dividends on the newly authorized shares would be initiated at the annual rate of $5 a share. The success of the Company under the defendants' management made possible such payments, but this precise distribution of dividends could, of course, not be made unless the changes in the stock structure were authorized as pro-

posed at the meeting, and this is obviously all that the letter intended to say. Plaintiff, however, has no difficulty in attributing to the passage a sinister meaning and argues that these dividends on the old and new stock were predicated on an approval of the Plan by the stockholders and constituted a "bribe" to the stockholders. Plaintiff, who received the extra dividend of four dollars per share (R., p. 250) does not allege that he ever objected to or declined to accept this so-called "bribe." He does not claim that his acceptance of this extra dividend barred him from any of his rights. Except as such a claim is symptomatic of the plaintiff's attitude towards the entire case and towards the management of the Company, the contention requires no comment.

V.

The Plan conformed to the statute.

In reliance upon the interpretation placed by the dissenting judge upon the New Jersey statute (L. 1920, Ch. 175), plaintiff urges, for the first time, that the Plan failed to conform to that Act because it entrusted too great a measure of discretion to the directors.

An examination of the Plan submitted to the stockholders demonstrates persuasively that it was in strict conformity with the Act. The Plan showed upon its face that:

(1) the employes were to be permitted to purchase stock by way of additional compensation for services to be rendered.

(2) the number of shares available to be allotted to employes was approximately 312,000.

(3) the Board of Directors were to determine

(a) when that stock should be offered;
(b) to whom to be issued; and
(c) upon what terms to be issued.

(4) the price was to be not less than the par value of the shares allotted.

(5) no stock was to be delivered until fully paid for.

(6) the directors were eligible provided they were employes.

The Plan did not state the number of shares and to whom those shares were to be given because to have done so would have made the Plan inflexible. The stockholders knew that the directors were to determine when the shares were to be issued, who the allottees were to be and the amount that each allottee should receive. It would have been impossible to have conferred that function upon the stockholders because they did not have the detailed knowledge that comes from the daily contact with the personnel and the daily changes in the business that the management possesses. If all the employes—that is the rank and file— were to participate, the Plan would have so provided. But it did not, the stockholders knew that it did not and the stockholders did not desire it. The essence of the Plan was to spur on the key men who most directly contribute to successful operation. The Plan was scientifically conceived, and was well designed to advance the interests of the Company. It contemplated the setting aside a sufficient amount of stock to create a reserve of stock which might be allotted by the management from time to time over a period of years. All of the stock was not to be distributed at once, otherwise the Plan would have so provided. On the other hand, the management was not required to appeal to the stockholders for authority on each occasion when it became advisable to make an allotment of stock to employes. The Plan adopted was flexible, adaptable to changing conditions and capable of producing the maximum benefit to the Company.

The administration of the Plan by the directors was a faithful, accurate execution of the stockholders' mandate.

Thus the formula that was adopted in allotting the stock to participants was carefully worked out with a view to furthering the object of the Plan. It was based upon:

1. The compensation paid to each participating employe, as a general measuring rod.

No fairer basic measure of an employe's worth to a corporation can be used.

2. The maximum allotment of stock to any one participant limited to an amount of stock having a par value equal to one-third of his compensation for 1930.

This was a reasonable limitation for the particular occasion.

3. The variation due to different degrees of actual and potential promise and ability between employes receiving the same compensation.

This afforded opportunity for superior executives to allow for a separate individual rating for each participant, rather than to handle them as a class. This was in every case determined for each participant by his immediate superiors and with such recommendation passed on for the ultimate judgment of the executive officers.

4. The measuring of such variation by rating each participant on a percentage basis as compared to a key man in the same department.

This was finally expressed by a percentage, thereby giving each participant the benefit of being considered for himself alone and of the recognization of his individual merit as well as his potentialities.

5. The application of such percentage to the maximum of one-third of the salary earned by the participant in 1930.

This was merely applying the participant's individual rating to his annual compensation in order to arrive at the number of shares to be allotted to him.

Thus, a man whose salary was $10,000 and who was rated at 60%, would be allowed to subscribe to shares having a par value of 60% of one-third of his yearly compensation, i. e., 60% of $3,333, which is $2,000 of stock at the par value of $25 per share, or 80 shares.

It is submitted that the Directors faithfully executed the mandate of the stockholders in adopting the foregoing formula.

Corporations of New Jersey have always had power to appoint such officers and agents as the business of the corporation may require, to allow them suitable compensation, and to make by-laws providing for the management of its property and the regulation and government of its affairs (L. 1896, Ch. 185, § 1). The New Jersey Corporation Act expressly provides that the business of every corporation shall be managed by its directors (L. 1896, Ch. 185, § 12; as amended by L. 1926, Ch. 318, § 4).

The by-laws of the Company provide that the salaries of all officers elected by the board of directors shall be fixed by the directors (Art. V, Sec. 1; R., p. 73), and that the salaries of all other agents and employes shall be fixed by the President subject to the control of the directors (Art. V, Sec. 2; R., p. 73).

Long prior to and at the time of the passage of the Act of 1920 under authority of which the Plan was submitted to the stockholders, it was the law of New Jersey that stock might be issued as compensation for any services rendered the corporation. The purpose of the Act was to give legislative approval, and, in the public interest, to encourage the policy adopted by many corporations of issuing stock to employes in order to secure the advantage of continuous service and increasing loyalty. The Act did not pur-

port to restrict the authority previously possessed by such corporations, or to limit the positive provisions of the statute, charter or by-laws vesting in the directors the general management of the affairs of the corporation. It expressly provided that the *privileges and powers thereby conferred were in addition to and independent of any and all powers and authority* conferred by any other law or laws and not in restriction or limitation of any powers otherwise belonging to corporations of New Jersey (L. 1920, Ch. 175, § 4).

Long before and at the time of the passage of the Act of 1920, it was also the law in New Jersey that *a contract made between directors and their corporation, authorized by the stockholders after notice of the directors' interest, was unassailable* save for actual fraud or want of power in the corporation. *United States Steel Corporation* v. *Hodge,* 64 N. J. Eq. 807, 813-814. The Act of 1920 specified how this assent of stockholders might be procured.

The Act does not prescribe details or mechanics of any plan to be submitted to stockholders. These details can be determined only by the directors. As the right to issue stock for services is established by law, the essence of such plans is merely compensation to employes. Always in New Jersey the power to fix compensation has been vested in the directors. *Beck* v. *The Pennsylvania R. R. Co.,* 63 N. J. L. 232.

The Plan is in strict accord not only with the State laws, the charter and by-laws of the corporation, but also with the general practice of other New Jersey corporations. In view of the constant changes in business conditions it would be unreasonable to attribute to the Legislature a design to have specified, either in a Certificate of Incorporation or in a plan to be submitted to the stockholders, the details of selection of employes to whom, over a period of years, such compensation should be awarded, or the amount of, or the terms upon which, the stock could be acquired. To make such a plan workable these features must necessarily be left for determination by the board of directors.

Plaintiff cites no New Jersey case in support of his contention. The fact is that there is none.

VI.

The Plan was not an invasion of any stockholder's preemptive right.

The preemptive right of a stockholder of a New Jersey corporation has never been held to be a contract right. In its inception it was but the result of a rule of equity adopted by the courts to defeat the acquisition by one or more stockholders of additional shares of stock of a new issue at a price more favorable than that afforded other stockholders. The rationale of the rule is to preserve the proportionate interest of the stockholders in the voting rights and property of the corporation.

Consequently, the rule has always been confined to an issue of stock solely for cash, and never has been applied to stock issued for either property or services, or for any other purpose resulting in a common benefit to all stockholders.

In all cases in New Jersey wherein the right of preemption has been sustained, there was an intention to obtain control of the corporation for the benefit of a few, at the expense of a great majority of the stockholders. (*Meredith* v. *Zinc & Iron Co.*, 55 N. J. Eq. 211, affd. 56 N. J. Eq. 454; *Way* v. *American Grease Co.*, 60 N. J. Eq. 263; *Grausman* v. *Porto Rican-American Tobacco Co.*, 95 N. J. Eq. 155, affd. 95 N. J. Eq. 223.)

In *Scott* v. *P. Lorillard Co.*, 108 N. J. Eq. 153, affd. 109 N. J. Eq. 417—relied upon by plaintiff—the issue of stock was not made under authority of the Act of 1920. Indeed, in that case defendant disclaimed proceeding under the Act of 1920. The proposed issue of stock in that case had no relation to services, but was predicated entirely upon the ownership of other shares; that is, stock was to be issued to officers and employes based upon their stockholdings.

No provision, express or implied, of the Company's charter, confers upon a stockholder any right of preemption in newly issued stock. And prior to 1926, there was no statute of New Jersey conferring any such right upon a stockholder.

The statutory right was first declared by Section 16, Chapter 318, L. 1926, which provides:

> "Upon the issue of capital stock for *cash,* unless otherwise expressly provided in the certificate of incorporation, or in by-laws adopted by two-thirds in interest of each class of stockholders, every stockholder shall have a right (unless waived by him) according to the number of shares held by him to purchase his pro rata proportion of the stock to be issued, at such price (which may be in excess of the par value), within such time and on such terms as shall be fixed and determined by the board of directors; * * *."

Subsequently, in *Bingham* v. *Savings Investment and Trust Co.* (Ct. of E. & A. 1928), 102 N. J. Eq. 302, speaking of the preemptive right of a stockholder in a New Jersey corporation, the Court said (p. 306): "The right of stockholders to participate in an increase in capital stock of the corporation is purely statutory, and subject to modification or repeal by the legislature."

The Act of 1926 is limited solely to stock issued for cash. It excludes, by failing to include, any issue for services or property. Indeed, the law of New Jersey always authorized the issuance of stock in payment for services. *Vineland Grape Juice Co.* v. *Chandler,* 80 N. J. Eq. 437, 440; L. 1917, Ch. 195.

The Act of 1920 expressly authorizes issuance of stock to employes as additional compensation for their services, and contemplates such an issue even before the services have been performed. Its purpose was to give legislative approval to a policy previously adopted by many corporations in the interest of all stockholders.

In the instant case, while the consideration paid when the title passed to the Trustees was cash, the Plan and the subscription agreement (Exh. G) provided that the services were to be additional consideration. The agreement stipulated in accordance with the provisions of the Plan that the allottee could not have delivery unless he completed the services for the year 1931. Except for the payment of par value, it was an issue of stock for services. Under the terms of the trust agreement if a subscription was cancelled for any reason, the stock went back to the Company.

While the relationship between the Acts of 1920 and 1926 has never been passed upon by any court in New Jersey, it is obvious that the Act of 1926 did not purport to repeal any of the provisions of the Act of 1920 and that those two statutes are not inconsistent with each other.

There was no change in voting rights, as the stock here involved is non-voting stock. Its distribution to employes for services to be rendered will redound to the common interest of all Company stockholders. The stockholders have themselves so decided.

The issue of stock under the Plan does not prejudice any preemptive right of a stockholder. It involves no constitutional question or invasion of plaintiff's contract rights.

VII.

There was no disposition of corporate assets contrary to the charter.

The allotment of this stock was in payment for services, not out of profits, but merely as a part of the expenses of the business.

The section of the charter quoted by plaintiff has application only to such profits as exist after the expenses of conducting the business have been fully paid. (*Bennett* v. *Millville Improvement Co.*, 67 N. J. L. 320; *Booth* v. *Beattie*, 95

N. J. Eq. 776, affd. 95 N. J. Eq. 776; *Berendt* v. *Bethlehem Steel Corp.*, 108 N. J. Eq. 148; *Harker* v. *Ralston Purina Co.*, 45 Fed. (2d) 929, cert. denied 284 U. S. 619; *Church* v. *Harnit*, 35 Fed. (2d) 499, cert. denied 281 U. S. 732; *Young* v. *U. S. Mortgage & Trust Co.*, 214 N. Y. 279; *Putnam* v. *Juvenile Shoe Corp.*, 307 Mo. 74; *Zwolanek* v. *Baker Mfg. Co.*, 150 Wis. 517.)

Profit participation creates an item of expense in the operation of the business, and the right of a corporation to permit a profit participation as means of compensation is now so well recognized as not to be the subject of debate. *Bennett* v. *Millville Improvement Co.*, 67 N. J. L. 329, and cases cited in preceding paragraph.

Plaintiff's contention, if sustained, would destroy all employes' stock plans, because it is their inherent characteristic to allot the stock to employes at a price under the market value. Plaintiff attaches great importance to the fact that in January, 1931, when the allotment of stock was made under the Plan, the market price of the stock was $112 a share, which was $87 more than the par value of $25 a share, and made a total difference of about $5,000,000 between the market value and the par value of 56,712 shares. As will be shown under Point IX, the market value at the time of the allotment is immaterial because no stock could pass to the employes until after December, 1931, by which time there had been a tremendous drop in its market value. The only real significance that the question of market value could have in the situation is entirely disregarded by the plaintiff, namely, that in any employes' stock plan, the price of the stock to the employes must be sufficiently low so that there will be a benefit conferred upon the employes and therefor an incentive to stimulate their efforts. Accordingly, the price must be fixed at a point which, so far as can be anticipated, will be below the market price when the employe becomes entitled to the stock. The ultimate value of these shares will depend largely on the services rendered by the allottees.

In *Harker* v. *Ralston Purina Co.*, 45 Fed. (2d) 929, cert. denied 284 U. S. 619, the Court said (p. 930):

> "Every corporation has the right incidental to its expressed powers and purposes to exercise such incidental power as is necessarily implied in the legitimate achievement of its expressed powers. Among such is the employment of efficient employees. At the time appellee made the contract before us, it contracted for appellant's services for five years, and obligated itself, in consideration therefor, to sell to him some of its capital stock at a price less than its market value. By selling the stock to the employee, appellee made sure that the employee would have a personal interest in the welfare of the corporation. The natural tendency of such interest was to increase the zeal of the employee and thus to forward the chances of success in the corporation's legitimate operations. Furthermore, it enabled the faithful employee, if he continued his employment to the maturity of his contract, to partake of the profits of the corporation. In a word, the contract contemplated the insurance of faithful efficient service to the corporation and a corresponding reward to the employee. Such a contract was clearly praiseworthy in its motives from the viewpoint of both parties, and the option to repurchase was clearly included to encourage the stay of the employee to the end of the period of his employment."

VIII.

Chapter 175, Laws of 1920, State of New Jersey, as well as the General Corporation Law of New Jersey, authorized the allotment of stock to employes at its par value and the services to be rendered by the allottees.

Plaintiff's apparent although somewhat ambiguous contention that the issuance of stock under the Plan for services to be rendered was unlawful for the reason that the stock of a New Jersey corporation can be lawfully issued only for

a fixed price, to which may be applied in part or full payment the wages or salaries which its employes might otherwise have earned, and not for a price compounded of cash and compensatory services, disregards both the law and the facts involved in the instant case. Immediately upon the issuance of the stock and delivery to the Guaranty Trust Company, as Trustee under the Agreement, the Guaranty Trust Company paid $25 per share for each and every share of stock so delivered to it. Thus, the Company received the par value of each and every share of stock. Further, the Company has received services during the entire year, services which were rendered in part upon the agreement that this stock should be delivered to those employes who were allotted stock under the Plan. Moreover, the very wording of the Act of 1920 authorizes the stock to be issued for "services", as it provides that a corporation "may carry out a plan" for "The issue * * * of its capital stock * * *, and the payment for such stock in installments or at one time with or without the right to vote thereon pending payment therefor in full, *and for aiding any such employees and said other persons in paying for such stock by contributions, compensation for services or otherwise.*"

Even before this statute was enacted, the Company had the right, under the decisions of the New Jersey courts, to issue its stock to employes for services to be performed. (*Vineland Grape Juice Co.* v. *Chandler,* 80 N. J. Eq. 437.)

IX.

The allotment of the stock, to be delivered only when the employe should have completed his services for the balance of the year and paid in cash the par value of the stock, was neither a violation of the directors' fiduciary obligation nor a waste of the Company's assets.

Plaintiff's discussion addressed to this point proceeds upon three erroneous assumptions.

First, he treats the case as though the directors, in making allotments of stock, were acting without authority and ignores the fact that at a special meeting called for the purpose, an overwhelming majority of the stockholders had *expressly* given authority to the directors to make such allotments to themselves as employes. All of the cases which plaintiff cites were cases in which directors had entered into contracts with themselves in the absence of such authority.

The rule in New Jersey and in the Federal courts, as well as in New York, is that the stockholders may, either by prior vote or by subsequent ratification, authorize the directors to deal with themselves and that under such circumstances the action of the directors is entirely valid. See *United States Steel Corporation* v. *Hodge,* 64 N. J. Eq. 807, 813-814; *Dana* v. *Morgan,* 219 Fed. 313, affd. 232 Fed. 85; *Ransome Concrete Machinery Co.* v. *Moody,* 282 Fed. 29; *Russell* v. *Patterson Co.,* 232 Pa. 113; *Colby* v. *Equitable Trust Co.,* 124 App. Div. 262, affd. 192 N. Y. 535; *Pollitz* v. *Wabash R. R. Co.,* 207 N. Y. 113.

This Court, in *Leavenworth* v. *Chicago &c., Railway Co.,* 134 U. S. 688, was confronted with the same contention as plaintiff makes here, that a transaction between a director and his corporation was void, despite the ratification by the stockholders. The Circuit Court had ruled against the plaintiff in that case and held that the ratification by stockholders was effective. In that case, as here, plaintiff relied upon *Aberdeen Railway Co.* v. *Blakie,* 1 Macqueen, H. L. 461; *Michoud* v. *Girod,* 4 How. 503; *Davoue* v. *Fanning,* 2 Johns. Ch. 252; *Wardell* v. *Railroad Co.,* 103 U. S. 651; *Twin Lick Oil Co.* v. *Marbury,* 91 U. S. 587,—of which this Court said (p. 708):

> "But, notwithstanding the general principle laid down in the cases cited, we concur in the views thus taken of the present case by the Circuit Court, and place our decision as to this branch of it on the same grounds."

Plaintiff asserts that the stockholders did not receive adequate notice, but we are unable to find in his discussion of this point any basis for such a conclusion. The Plan (a copy of which accompanied the notice of the meeting), expressly provided that "the Board of Directors may * * * by way of additional compensation for services to be rendered, offer and allot such stock for subscription, to employees * * * at such prices not less than the par value of the shares allotted * * * as shall be determined * * * pursuant to authority to be granted by the Board of Directors to the President for such purpose." It also provided that "no employee or person actively engaged in the conduct of the business of the corporation, or its subsidiaries, shall be deemed ineligible to the benefits of the Plan by reason of his being also a director * * *" (R., pp. 47-49). It would be difficult to draft a notice which would more clearly set forth the exact authority which was intended to be given to the directors.

Second, plaintiff's argument proceeds upon the further erroneous assumption that the directors should have allotted the stock to employes at a price as high as could be obtained in the open market; he ignores completely that what was submitted to the stockholders and approved by them was a Plan *for the benefit of employes* under which stock was to be allotted as stated in the Plan, *"by way of additional compensation."* Its eventual worth would depend on their services, so that they would realize that their own efforts would enhance its value.

Third, plaintiff also erroneously assumes that the market value of the stock on January 28, 1931 represented a profit to the allottees at that time. This is clearly not the fact. At that time the employes were merely permitted to subscribe to the stock allotted to them. There was no sale to them at that time, nor did title pass, nor any dominion over the stock (Exh. G, R., pp. 110-121; Pltff's Bill of Par., R., p. 251). No employe could receive stock until he had com-

pleted his services for the year 1931 and had also paid in full the par value in cash of the stock allotted to him.

Accordingly, plaintiff's contention that the allottees received a profit of $87 a share because the market price of the stock was $112 in January, 1931, is refuted completely by the facts. The employes could not under any circumstances become entitled to the stock until after December 31, 1931. Before the end of November, 1931, the market price of the stock had fallen to $71 per share (R., p. 194). We assume that this Court may take judicial notice that the period subsequent to November, 1931, was "one of continuous price recession." *Galveston Electric Co.* v. *Galveston,* 258 U. S. 388, 402. If the book value of the stock be taken into consideration, it is to be noted that in January, 1931, it was less than $42 a share (Exh. U, R., p. 179). Included in that valuation is $54,000,000 for brands, trademarks, patents and good will, which makes approximately $11 a share.

The price at which the stock was to be offered under the Plan was a matter which the stockholders had left with the directors for determination, and the events which have occurred since the date of the allotment have amply justified the wisdom of the directors' judgment in fixing such price at par.

In 1929 there had been a severe market break, and the directors had a right to foresee a likelihood of its repetition. There were then distinct signs of a great world depression and it was an act of highest sagacity to spur on the Company's man power towards unusual efforts to stem the tide of panics and slumps in safeguarding the interests of its stockholders. The morale of the Company's executives and employes has been its most valuable asset in its present fight against universal world conditions more disturbing than have ever faced the industry.

It is a matter of common knowledge that all tobacco companies were faced with agitation in a number of States for an increase of taxes upon tobacco products, all of which

might affect the business of the Company and the market value of its stock.

It is also a matter of common knowledge that during the past three years many corporations which have had employes' stock plans in effect have failed to make sufficient allowance for the downward trend of the market values of the stock. In the case of stock plans where the market price has fallen below the subscription price, the result has been not only financial loss instead of gain to the employes, but a corresponding discouragement and discontent, instead of the encouragement and stimulation which is the primary purpose of all such plans.

The plaintiff complains that the formula used in the allotment of the stock permitted the most valuable employes to subscribe for more stock than those who were less valuable, and resulted in allowing the chief executives to subscribe for a large proportion of the stock allotted. But the Plan, being a form of "additional compensation," necessarily carried with it the recognition of different degrees of worth. For example, an assistant factory superintendent should not and would not, in any well run business, receive the same compensation as his immediate superior; and this would apply throughout the entire personnel. Naturally, therefore, any formula to meet the requirements of the situation, should, when applied to the participants, result in the major officials receiving the greater proportion. Obviously, the stockholders must have known when they approved the Plan that the chief executives would receive much larger allotments than minor employes. While such allotments were large, the benefits to the Company, as already demonstrated, have been correspondingly great. The duties, responsibilities and services of these chief executives, and the burdens they carry, are described at length in the Answer (Fourth Separate Defense, R., pp. 205-239) and were all well known to the stockholders.*

* See page 10, *supra*.

This contention of plaintiff goes merely to a question of corporate policy with respect to which the plaintiff must abide by the expressed will of the great body of the stockholders of the Company, unless he wishes to avail himself of the right afforded to any dissatisfied minority stockholder of having his stock appraised and being paid such appraised value by the corporation (Laws of 1920, Chap. 175, § 2).

Plaintiff seems to believe that he, a single stockholder holding but 600 shares of Common Stock out of a total of 4,688,000 shares outstanding, is the one to determine what the compensation of the employes shall be and to how much each employe is entitled. He would take the management of the corporation not only from the directors but from the majority stockholders. He would disregard the law of New Jersey as laid down in *Bingham* v. *The Savings Investment Company,* 102 N. J. Eq. 302, in which the court said (p. 304):

> "A meeting was thereupon held for that purpose, at which the holders of eight thousand seven hundred and twenty-one shares out of a total issue of ten thousand were present; eight thousand five hundred and twenty-five shares being voted in favor of the agreement, and the holders of two hundred and eleven shares (being the complainants) voting against it. In other words, approximately eighty-three and eighty-five hundredths per cent. of the stock held by those in attendance was voted in favor of the adoption of the agreement and only two and eighty-five hundredths per cent. against it. In such a situation, as was stated by this court in *Berger* v. *United States Steel Corp.*, 63 N. J. Eq. 812, in considering a like contention made under similar conditions, it cannot reasonably be expected that the court is impressed with the belief that the complainants and their fellow-stockholders will suffer any substantial injury by the consummation of the scheme, and that unless it appears that the proposed action is without legal authority, this court should see to it that this overwhelming majority of shareholders are not deprived of their rights by the very few dissentients."

Plaintiff would confer either upon himself or upon the Court powers which clearly belong to the stockholders and as to which the stockholders constitute the court of last resort. (*Bisbee* v. *Midland Linseed Products Co.,* 19 Fed. (2d) 24; *Heinz* v. *National Bank of Commerce,* 237 Fed. 942; *Brictson Mfg. Co.* v. *Close,* 280 Fed. 297; *DuPont* v. *DuPont,* 256 Fed. 129; *Farmers Loan & Trust Co.* v. *Hewitt,* 94 N. J. Eq. 65; *Elevator Supplies Co.* v. *Wylde,* 106 N. J. Eq. 163; *Kelly* v. *Kelly-Springfield Tire Co.,* 106 N. J. Eq. 545; *Madsen* v. *Burns Bros.,* 108 N. J. Eq. 275; *Storrs* v. *James Butler Grocery Co.,* 96 N. J. Eq. 359; *General Investment Co.* v. *American Hide & Leather Co.,* 97 N. J. Eq. 214; *Putnam* v. *Juvenile Shoe Corp.,* 307 Mo. 74.)

X.

The resolutions authorizing allotment of the stock were made under the express authority conferred upon the directors by the stockholders.

Plaintiff again passes over the fact that what the directors did in making allotments was with the expressed consent of the stockholders. He also eliminates from consideration the full information promptly given by the board to the stockholders of the actual allotments, such information being contained in the pamphlet (Exh. G) mailed to stockholders early in March, 1931, accompanying the notices of the annual meeting to be held on April 1, 1931.

Indisputably, the stockholders knew when they voted for the Plan that under its terms the allotments were to be made by the board of directors and that if the Plan was approved, the directors who were employes would have authority to allot stock to themselves. Having this knowledge, the stockholders voted to give the directors such power and authority. No reason appears why this mandate of the stockholders should not be given its natural effect.

It has been already pointed out in Point III, *supra*, that plaintiff's theory, that directors who were employes were disqualified from voting for the preliminary resolution to submit the Plan to the stockholders, would automatically prevent any Plan under this Act from ever being submitted to the stockholders of a corporation, all or the majority of whose directors were employes, unless those important employes who are directors are excluded from its benefits.

It should now be noted that plaintiff's theory that directors who were employes were disqualified from voting for an allotment to themselves, notwithstanding the fact that the terms of the Plan approved by the stockholders expressly provided that director-employes might participate in the Plan, would prevent any New Jersey corporation the majority of whose directors were employes from ever making allotments under a plan containing such a provision. All of these contentions of plaintiff are the result of his refusal to recognize the well established rule that no such disqualification on the part of directors exists when the stockholders—with notice that the directors have an interest—have given authority to them to act.

For a number of years the Company's board has consisted almost entirely of executive employes. Obviously, the stockholders have the right to elect employes to the board, and no reason appears why a corporation whose stockholders follow such a policy should be precluded from taking advantage of the Act in question. Nor is there anything in the Act itself indicating any legislative intention to limit the right of stockholders in determining what employes might participate in the benefits of any such plan. On the contrary, the Act leaves full power with respect to the provisions of the plan in the hands of the stockholders.

McNab v. *McNab and Harlin Mfg. Co.*, 62 Hun 18, affd. 133 N. Y. 687, relied upon by plaintiff, is not applicable. In that case it appeared that there had been neither prior

authorization nor subsequent ratification by the stockholders. For the rule prevailing in the Second Circuit, see *Ransome Concrete Machinery Company* v. *Moody,* 282 Fed. 29.

Notwithstanding plaintiff has failed to assign as error the refusal of the District Court to strike out the Fourth Separate Defense, he urges that the facts therein set forth are wholly irrelevant.

He bases his argument upon the premise that the Plan, although adopted by the requisite vote of stockholders pursuant to the Act, nevertheless constitutes an illegal and wrongful act on the part of the defendants.

We believe we have fully demonstrated in this brief that the Plan was adopted in strict conformity with the Act and is legal and valid in all respects. Since the premises upon which the plaintiff bases his conclusion are without legal support, his conclusion must likewise necessarily fall.

Jacobson v. *Brooklyn Lumber Co.,* 184 N. Y. 152, cited by plaintiff, has no application. It did not involve any element of contract or agreement to pay for services to be rendered in the future. It was a case where directors were majority stockholders and were using that position for the purpose of depriving the minority stockholders of their rights.

The law is clear that, even in the case of a director, if he renders services not incidental to his duty as such, under agreement that he is to be paid therefor, he is entitled to compensation. (*Corinne Mill, Canal & Stock Co.* v. *Toponce,* 152 U. S. 405; *Fitzgerald and Mallory Construction Co.* v. *Fitzgerald,* 137 U. S. 98; *Montana Tonopah Mining Co.* v. *Dunlap,* 196 Fed. 612; *Bennett* v. *Millville Improvement Co.,* 67 N. J. L. 320; *Chandler* v. *Monmouth Bank,* 13 N. J. L. 255; *In re Gouverneur Pub. Co.,* 168 Fed. 113; *Wellington Bull & Co., Inc.* v. *Morris,* 132 Misc. 509, affd. 226 App. Div. 868; *Fox* v. *Arctic Placer Mining & Milling Co.,* 229 N. Y. 124; *Bagley* v. *The Carthage, W. & S. H. R. R. Co.,* 165 N. Y. 179.)

XI.

The allotment of the stock in January, 1931, "by way of additional compensation for services to be rendered" was authorized by the statute and by the Plan.*

Plaintiff again disregards the facts in asserting that the allotment on January 28, 1931, constituted a sale from which the 528 employes received a profit of $5,000,000. He goes so far as to state that the provision of the Subscription Agreement, made with the employes, that the allotment was "by way of additional compensation for services to be rendered by you to the Company and/or its subsidiaries to and including December 31, 1931," was, in the language of the plaintiff's brief (p. 30) "nothing more than a conveyancer's device invented to impart consideration into the transaction which was recognized as otherwise lacking of adequate consideration."

The statute by its express terms provides for the issue of the stock "to any or all of its employees and those actively engaged in the conduct of its business. * * * and for aiding any such employees and said other persons in paying for such stock by contributions, *compensation for services,* or otherwise."

The Plan itself contained, twice repeated, the specific provision that the allotment of stock to employes was to be made *"by way of additional compensation for services to be rendered"* (Plan, Pars. I and III, R., p. 47). Also, the notice of the special meeting of July 28, 1930, in addition to enclosing a copy of the Plan, referred to "the issuance and sale of the shares * * * to employees and those actively engaged in the conduct of its business, *by way of compensation for services to be rendered"* (R., p. 43).

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* This is a variation of Point VIII, *supra.* The only reason we discuss it again as a separate point is that plaintiff has so treated it.

Plaintiff's other grounds of objection to the allotment are wholly specious. The Act provided specifically that the allotment could be made to Trustees on behalf of the employes.

The Act provided, also, as did the Plan, that allotments could be made not only to "any or all employes," but also to "those actively engaged in the conduct of its business."

Conclusion.

Without complying with the rules necessary to give jurisdiction by first exhausting his remedies within the corporation, plaintiff has sought a forum foreign to the corporate domicile to adjudicate matters dealing with the internal affairs of the Company. He brings what he is pleased to call a representative action. No single stockholder has come forward to join his cause. Owning less than one one-hundredth of one percent of the Company's outstanding stock, he asks the courts to follow him in overriding the expressed wish of the overwhelming majority of the stockholders and determining in their stead what shall be done with the Company, what policies it shall pursue with respect to the compensation of its officers and employes, who constitute its directing head. We submit that in point of fact no less than in point of law, plaintiff's case must fail, and the decree should be affirmed.

Respectfully submitted,

JOHN W. DAVIS,
NATHAN L. MILLER,
Counsel for Respondents.

APPENDIX A.

Statute Under Which the Plan Was Authorized.

158. Power of domestic corporation to provide for participation of employees in purchase of stock, profits, welfare work or management.

Any stock corporation formed under any law of this state may, upon such terms and conditions as may be determined in the manner hereinafter designated, provide and carry out a plan or plans for any or all of the following purposes:

(a) The issue or the purchase and sale of its capital stock to any or all of its employees and those actively engaged in the conduct of its business or to trustees on their behalf, and the payment for such stock in instalments or at one time with or without the right to vote thereon pending payment therefor in full, and for aiding any such employees and said other persons in paying for such stock by contributions, compensation for services, or otherwise.

(b) The participation by all or any of its employees and such other persons in the profits of the corporate enterprise or of any branch or division thereof. Such share in such profits shall be regarded as a part of the corporation's legitimate expenses.

(c) The furnishing to its employees wholly or in part at the expense of such corporation of medical services, insurance against accident, sickness or death, pensions during old age, disability or unemployment, education, housing, social services, recreation or other similar aids for their relief or general welfare.

(d) The nomination and election by its employees of one or more thereof as a member or members of its board of directors, such member or members to have the same rights

and authority and be subject to the same duties and responsibilities as the directors to be elected by the stockholders. Every such corporation may determine and provide the manner of making any such nominations and calling and conducting any such election, the time or times, the place or places where it shall be held, what number of years of service or other qualifications shall entitle its employees to one or more votes, whether said votes shall be cast personally or by proxy, what number of votes shall be required to elect, and such other restrictions and conditions as may be deemed expedient and proper; *provided, however,* that the voting at all such elections shall be by secret ballot, and that if less than a majority of employees entitled to vote participate in the election, such election shall be inoperative and void. Any vacancy occuring in any such office by reason of a failure to elect or otherwise, shall be filled in the manner provided for in the plan, and in the absence of such provision such vacancy shall be filled from among the employees or stockholders by the board of directors. (L. 1920, ch. 175, p. 354, § 1; S. 47-183.)

158a. Manner of exercising privileges and powers granted by preceding section.

Any of the privileges and powers hereinbefore granted may be exercised in the manner following:

(a) By including appropriate clauses therefor in the original articles of incorporation or by-laws at the time of organizing the corporation.

(b) Where the corporation has been formed without the said charter or by-law provisions the board of directors shall first formulate such plan or plans and pass a resolution declaring that in its opinion the adoption thereof is advisable, and shall call a meeting of the stockholders to take action thereon. The stockholders' meeting shall be held upon

such notice as the by-laws provide, and in the absence of such provision upon ten days' notice given personally or by mail. If two-thirds in interest of each class of stockholders present at said meeting and voting shall vote in favor of any such plan or any modification thereof, the said plan shall thereupon become operative.

(c) In case any corporation shall hereafter adopt a plan providing for the issue of new stock under subdivision (a) of section 1 of this act, or any plan provided for in subdivision (d) of such section 1, any stockholder holding stock issued by such corporation before the enactment of this law, not voting in favor of such plan, may, within thirty days after the adoption thereof, file with the secretary of the company a dissent in writing therefrom. The person so dissenting shall within ten days after the filing of such dissent, and upon five days' notice to the corporation, apply by petition to the Circuit Court of the county in which the corporation has its principal office for the appointment of three disinterested appraisers to appraise the fair value of the stock held by such stockholders in said corporation and issued prior to the enactment of this law without regard to any depreciation or appreciation thereof in consequence of the adoption of such plan, whose award (or that of a majority of them) when confirmed by the said court, shall be final and conclusive on all parties, and said corporation shall pay to such stockholder the value of such stock as aforesaid. On receiving such payment, or on a tender thereof, or in case of any legal disability or absence from the state, on the payment of such award into said court, said stock shall be transferred to the said corporation, to be disposed of by the directors thereof or to be retained for the benefit of the remaining stockholders; and in case the said award is not paid within thirty days from the filing of said award and confirmation by said court and notice thereof to be given in the manner aforesaid unto such corporation, the amount of the award shall be

a judgment against said corporation, and may be collected as other judgments in said court are by law collected. Such court may fill any vacancy in the board of appraisers occurring by refusal or neglect to serve or otherwise. The charges and expenses of the appraisers and appraisal as approved by the court shall be paid by the corporation; *provided, however,* that the corporation may at any time before the proceedings hereinbefore mentioned are instituted or completed elect to permit such dissenting stockholder to subscribe for his proportionate share of such new stock issued under section one, subdivision a, in which event the said proceedings shall not be instituted, or, if instituted, shall be terminated upon the payment of the appraisal expenses as aforesaid by the corporation. (L. 1920, ch. 175, p. 355, § 2; S. 47-184.)

158b. Change or abolishment of plan adopted; restoration of moneys to employees.

Any plan adopted as aforesaid may be recalled, abolished, revised, amended, altered or changed in the same manner as is herein provided for its adoption; subject, however, to the restoration by the corporation of any moneys contributed by employees or those actively engaged in the conduct of the corporate business, and for which no stock or other equivalent has been issued. (L. 1920, ch. 175, p. 357, § 3; S. 47-185.)

158c. Privileges and powers conferred by act in addition to other powers and authority.

The privileges and powers conferred by this act shall be deemed to be in addition to and independent of any and all powers and authority conferred by any other law or laws, and not in restriction or limitation of any of the powers now permitted to corporations of this state. (L. 1920, ch. 175, p. 357, § 4; S. 47-186.)

APPENDIX B.

Decree Entered on Mandate.

At a Stated Term of the United States District Court for the Southern District of New York, held at the Post Office Building, in the Borough of Manhattan, City of New York, on the 11th day of July, 1932.

Present—Hon. ROBERT P. PATTERSON, District Judge.

RICHARD REID ROGERS, *Plaintiff,* against GUARANTY TRUST COMPANY OF NEW YORK, JUNIUS PARKER, GEORGE W. HILL, C. F. NEILEY, A. C. MOWER, VINCENT RIGGIO, CHARLES A. PENN, J. B. HARVIE, R. J. BOYLAN, C. S. KEENE, J. K. FLETCHER and THE AMERICAN TOBACCO COMPANY, *Defendants.*	Consolidated Cause. E—59-307.
RICHARD REID ROGERS, *Plaintiff,* against THE AMERICAN TOBACCO COMPANY and T. R. TAYLOR, *Defendants.*	

A decree in the above-entitled consolidated cause having been entered in this Court on the 23rd day of February, 1932, in favor of the defendants Guaranty Trust Company of New York, Junius Parker, George W. Hill, Vincent Riggio, J. B.

Harvie, R. J. Boylan, T. R. Taylor, and The American Tobacco Company, denying plaintiff's motion for an order to strike out the first, second, third, and fourth separate defenses of the answer therein, and for a decree in accordance with the prayer of the amended bill of complaint therein, or, in the alternative, for an order for an injunction *pendente lite,* the said decree having dismissed each of the bills of complaint therein without prejudice to the enforcement of the rights of plaintiff, if any, in the courts of New Jersey, and plaintiff having taken an appeal from the said decree to the United States Circuit Court of Appeals for the Second Circuit, from which a mandate has duly issued to this Court affirming said decree of this Court, and it appearing from the decision of the said Circuit Court of Appeals that the said cause was adjudicated by said Circuit Court of Appeals in favor of the said defendants on the merits, it is hereby

ORDERED, that the defendants Guaranty Trust Company of New York, Junius Parker, George W. Hill, Vincent Riggio, J. B. Harvie, R. J. Boylan, T. R. Taylor and The American Tobacco Company have judgment against the plaintiff Richard Reid Rogers that each of the bills of complaint herein be and the same is hereby dismissed with $25 costs, which costs will be fixed by the Clerk against the said plaintiff, and for which, if not paid in ten days, execution will issue upon the application of any party in interest.

ROBERT P. PATTERSON,
U. S. D. J.